

April 23, 1985

STATEMENT OF
THOMAS P. COSTIN, JR., PRESIDENT
NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES

Mr. Chairman, members of the the Committee -- my name is Thomas P. Costin. I am President of the National Association of Postmasters of the United States.

We greatly appreciate this opportunity to testify on behalf of the nation's 29,700 Postmasters on the critically important issue of developing a new retirement system for Postal employees and other Federal employees covered by Social Security. We are especially grateful to the Chairman for his leadership in framing the relevant issues and assuring the performance of the background and analytical work necessary for the Committee's deliberations. In this connection, we acknowledge the Congressional Research Service's (CRS) expert report on designing a retirement system for Federal workers. We agree with the Chairman that this study clearly meets the objective of providing, for all interested parties, the conceptual and analytical tools necessary to analyze the numerous issues involved in the development of a supplemental retirement plan.

Even a casual reading of the CRS report reveals how complicated and detailed the matter of pension plan design can be. It is very easy to become engrossed in the technical details of the CRS analysis and lose sight of our main purpose here today, which is to communicate the Postmasters' view on the major features of the new complementary pension plan. To this end, we shall be guided in my testimony by the specific questions raised in the Chairman's correspondence of March 18, 1985.

Appropriate Cost of the New Program:

When Congress debated and enacted Social Security coverage for Federal workers hired after 1983, almost everyone recognized that it would be necessary to establish a new Federal pension program designed to complement Social Security benefit levels. It is apparent, from our perspective, that most of the individual members of this Committee favor the development of a new retirement plan which, when added to Social Security, would provide benefits comparable to those under the current Civil Service Retirement System.

This approach, of course, assumes that the present CSRS is adequate. We do not believe this to be the case and have consistently advocated improvements in the system which would enable postal workers to keep abreast of the progressive change which has characterized private sector pension plan development over

the past decade. The CSRS, once a model for non-Federal employment practice, has had no improvement in over 16 years. While the CSRS is a good basic plan, it fails to provide income after retirement sufficient to enable employees to maintain their pre-retirement standard of living -- in our view, the central objective of any retirement system.

Nevertheless, we understand full well that the status of incumbent Postal Workers is beyond the scope of these proceedings, which are confined to the terms of the retirement system applicable to post-1983 hirees. Under these circumstances, it is appropriate to start with the objective of equalizing pension compensation for all Postmasters and other Postal Workers. This is accomplished by designing a pension for Social Security covered employees equal to the value of CSRS, less the value of Social Security. In determining the "equal value," we endorse the employer normal cost approach developed by the CRS. Accordingly, the new supplemental plan (exclusive of Social Security) should carry a normal cost to the employer of approximately 18.64 percent of payroll. Under the CRS actuarial cost model, this equals the employer's normal cost of CSRS, net of administrative expenses (.05%) and the cost of unique provisions for special groups (.45%), less the employer's normal cost for Social Security (6.06%).

We wish to emphasize that this figure is intended only to preserve that portion of total compensation presently devoted to retirement income. It simply reaffirms the principle of equal-pay-for-equal-work among all postmasters, regardless of their date of appointment. It goes without saying that we are unalterably opposed to the Administration's proposal, or any other, which seeks to cut pension compensation for new employees through the establishment of a supplemental plan which, when added to Social Security, falls below the present Civil Service standard. There are no grounds, in fact or equity, for further gutting the benefit compensation of Federal workers who have already borne a disproportionate share of the Administration's austerity measures.

Benefit Distribution:

We know that under the present CSRS the relationship between pension income and preretirement earnings is the same across all income levels. Social Security, on the other hand, replaces a higher proportion of preretirement earnings for those at the lower end of the income scale. This poses a major design question for pension planners, that is, "How much of this Social Security 'tilt' should be eliminated by the supplemental plan?"

This is a particularly vexing problem for NAPUS. Our organization represents Postmasters with an average annual salary

of approximately \$30,000. Salaries range, however, from under \$4,500 to over \$60,000. We represent part-time Postmasters in the rural areas whose salaries are predicated on 2 to 6 hours of work per day, together with some of the highest paid postal managers, responsible for the entire operation of the largest postal installations in New York, Washington, Chicago and other major metropolitan areas.

This sprawling range of salaries leads me to conclude that the costs and benefits of the new retirement system should be distributed equally across the salary scale. We are convinced that the fairest and most equitable treatment of all Federal workers, respecting the distribution of benefits, requires the duplication of the current CSRS structure to the maximum possible degree.

This, of course, dictates a new supplemental plan which incorporates an offset of 100 percent of the primary Social Security benefit. The objective is to design a program which replaces the same percentage of preretirement earnings, regardless of job classification and rate of pay.

The Level of Employee Contributions:

From our viewpoint, the issue in these proceedings concerns the employer's obligation to finance retirement income. If the employees, individually or through their organization, wished

to purchase greater retirement security by deferring personal income through insurance annuities, Individual Retirement Accounts or other forms of retirement income outside the employment relationship, the employer does not have an interest. For example, NAPUS sponsors an Individual Retirement Account program for its membership. Similarly, employee contributions to the pension fund, while having a direct impact on the size of the pension, do not influence total compensation or employment costs in one direction or the other. Retirement income attributable to employee contributions, therefore, should not be included in an evaluation of pension adequacy any more than savings accounts, life insurance, stocks, or other personal assets which affect retirement security.

Whether employees should contribute to the new plan, thereby enabling them to reach higher pension levels than are obtainable under a noncontributory plan, will be a basic policy matter for the respective employee organizations to decide. Some unions encourage employee-financed additions because they have little confidence in the employee's ability to manage money in a way which permits voluntary savings outside of payroll deductions. On the other hand, we know that the vast majority of private sector plans are noncontributory. This practice reflects the reality that it is cheaper for the employer to finance pensions than for the employees. First of all, employee contributions are loaded for the cost of returning employee contributions

at resignation or discharge, while employer contributions are nonrefundable. So, for example, if pension planners wished to add a pension increment worth 1.0% of payroll, it would require approximately 1.25% of pay if the obligation was to be financed by employee contributions. The extra contribution is necessary to cover the cost of refunded contributions.

Secondly, employee contributions are paid with after-tax wages and are thus subject to income taxes and payroll taxes in the nature of Social Security and pension contributions. Employer contributions are completely tax sheltered. Under these circumstances, the only economically sensible approach is to design the new retirement system in a fashion which does not require direct employee contributions beyond those required under social security.

We are aware of the prospect of sheltering employee contributions from Federal income tax by establishing a capital accumulation plan. By design, such a program would enable employees to capture additional employer matching contributions (i.e., extra compensation) by making voluntary contributions of their own. While we are not dogmatically opposed to these programs, we regard them as a third and separate tier of pension development which should be secured only after a solid core of employer-paid benefits is obtained.

In summary, the capital accumulation plan approach should be considered the next generation of pension plan provisions -- the kind which might, for instance, eventually supplement the CSRS benefits of incumbent Federal workers. At this stage, however, we oppose the capital accumulation approach as a substitute for cost-equivalent basic pension benefits. Assessing the value of the pension compensation represented by a capital accumulation program requires speculation over employee participation rates. On this, we have no firm judgment. It is likely, however, that participation rates will increase with salary, thus allocating a disproportionate share of the value to the highest paid classifications. For the same employer contribution, we prefer to allocate more pension compensation to basic benefits which are evenly distributed among all income levels and which are not contingent on the employees' ability to generate additional savings.

The Proper Level of Funding:

As the Committee knows, pensions for postal employees are financed through the Civil Service Retirement and Disability Fund, which is part of the Unified Budget of the Federal government. The Fund serves as an accounting mechanism into which various payments are deposited as income and from which benefits and administrative expenses are paid. As a practical matter, the

trust fund exists mainly for bookkeeping purposes -- to identify and allocate cost within the Federal budget.

Civil Service Retirement System income, collected on behalf of postal employees, comes from four main sources:

1. Employees contribute 7.0 percent of basic pay which excludes COLA, overtime, bonuses, premium pay and other allowances.
2. The Postal Service makes two separate contributions to the CSRS Fund.
 - a. An amount matching the amount contributed by postal employees.
 - b. An annual amount representing the estimated increase in the unfunded liability attributable to increases in pay on which benefits are computed. The estimated increase in the unfunded liability as determined by the Office of Personnel Management is paid in 30 equal annual installments with interest (computed at the rate used in the most recent valuation of the CSRS -- currently 5%), with the first payment due at the end of the fiscal year in which an increase in basic pay becomes effective.

- 10 -

3. The U.S. Treasury makes two separate transfers from the General Fund to the CSRS Fund:
 - a. Annual payments equal to:
 - 1) interest on the total amount of obligation in excess of current assets, as if that amount represented revenue actually appropriated and invested, and
 - 2) those portions of annuities paid during the year attributable to credit allowed for military service.
 - b. Appropriations in 30 equal annual installments to finance any increased liability resulting from legislation which authorizes new or liberalized benefits except cost-of-living adjustments.
4. The Fund earns interest by investing revenue received from the first three sources. Money in the Fund can, by law, only be invested in interest-bearing U.S. Government securities.

In these proceedings, we are concerned with determining the appropriate level of funding for the new supplemental plan.

Some observers are advocating the "full funding" of pension obligations. We assume that this means the regular annual payment of normal cost contributions which, under the CRS actuarial model, will equal 24.7 percent, including Social Security (but excluding administrative expenses and the cost of unique provisions for special groups), if the new plan equals the cost of the present CSRS. This rate of contribution is over twice the actual rate presently being paid by the Postal Service on behalf of Postmasters, under the formula described earlier. We estimate this contribution rate to be 11.0 percent of gross pay.

We are reminded by the CRS and other independent analysts that the CSRS Fund is a part of the Unified Federal Budget of the Federal government. Consequently, all payments to the Fund from the Treasury, and all money invested by the Fund in Treasury-held securities, are merely intergovernmental transfers. If Congress appropriated additional revenue from the Treasury to the Fund for the purpose of establishing credit against accruing future liabilities, this additional revenue would immediately return to the Treasury in the form of bonds. The transactions would cancel each other, although the Fund, as a government account, would show an improved financial condition. This credit would, however, be reflected in a corresponding increase in the national debt. Therefore, there would be no effect on CSRS participants, nor on taxpayers, if amounts were credited to the Fund

- 12 -

beyond revenue needed for operating expenses, i.e., benefit payments, refunds, and other administrative expenses. In other words, there is no practical advantage to "fully-funding" or "advance-funding," to any degree, over paying the pension on a current disbursement or "pay-as-you-go" basis.

Under the circumstances, we see no real purpose in adopting a funding standard which would require off-budget agencies such as the Postal Service to double their current per capita outlay and aggravate an already strained financial position. We support a level of funding which would require current cash outlays by the Postal Service equal to the per capita contributions for the pre-1984 workforce. Certainly, this position would be different if we were dealing in an industry where bankruptcy and plan termination rates were high. But, we are satisfied that pensions backed by the Federal government taxing authority will be financially secure without full advance funding.

Vested Benefits:

The vesting period should not emerge as a major issue in developing the new retirement plan. The present 5-year rule, applicable to voluntary and disability benefits, is a reasonable compromise between those who seek to reduce employee turnover by encouraging longer service and those who wish to provide some mobility between the Federal and non-Federal sectors. We endorse

the inclusion of a 5-year "cliff" vesting provision which would operate under the same rules as the present CSRS. If an employee works beyond the 5-year period, then the accrued benefit at the time of resignation is payable at age 62. However, in lieu of deferred benefits, the employees may divest themselves of the employer contribution by accepting a return of their own contribution without interest.

Although the 5-year rule appears to be more liberal than the 10-year ERISA standard typical of the private sector, the actual cost differences are marginal. ERISA does not permit the forfeiture of vested benefits based upon the employer's contributions, even if the employee withdraws his own contributions. Moreover, all employee contributions must be returned with interest under ERISA standards.

Summary:

We have commented briefly on the five specific issues on which the Committee intended to focus today. There are, of course, several other important provisions of the new retirement system which have not been specifically discussed, such as the postretirement escalator clause and eligibility requirements for early retirement. The Postmasters' position on these, and the issues treated hereinabove, is expressed in the following outline

- 14 -

which sets forth the details of the supplemental retirement plan which we are willing to support:

- Pension Benefit Formula 1.78 percent of high-3 x years of service.
- Social Security Coordination Less 100 percent of Social Security.
- Post-retirement Adjustments 100 percent of the CPI increase.
- Eligibility Requirements for Unreduced Benefits Age 55 with 30 years, or Age 60 with 20 years, or Age 62 with 5 years.
- Social Security Supplement Payable between ages 55 and 62; equal to the Social Security benefit payable at age 62.
- Vesting 5 years, payable beginning at age 62.
- Disability Applicable to any person who is unable to perform in position during first 24 months; after 24 months, payable if totally and permanently disabled for any occupation; benefit equal to 60 percent of predisability pay less Social Security, or accrued retirement benefit, whichever is greater.
- Survivor Benefits For preretirement death, 55 percent of accrued retirement benefits. For postretirement death, if elected, a reduction in the retirement annuity of 2.5 percent of first \$3,600 annually, plus 10 percent on amounts over \$3,600. Survivor benefit is calculated at 55 percent of annuity before reduction.

- 15 -

- Employee Contributions None.
- Capital None.
Accumulation Plan

A pension program containing these central ingredients does not exceed the costs of the current CSRS and accomplishes several objectives critical to our organization:

- (1) It sets pension compensation for Social Security-covered employees at the same level as non-Social Security-covered employees by equalizing employer pension costs between the two groups.
- (2) It distributes the costs and benefits uniformly across job classifications and salary levels, thereby duplicating the structure of the present CSRS.
- (3) It places the weight of costs and benefits on the basic benefit formula without the use of contingent benefits associated with a voluntary capital accumulation plan.
- (4) It preserves the main features of the present CSRS in the areas of postretirement adjustments, vesting, and early retirement.

- 16 -

We urge the Committee to give full and careful consideration to these essential objectives. A retirement program designed in conformance with these principles, while failing to correct for the deficiencies in the current pension system, provides the fairest and most equitable adjustment of taxpayers' and employees' interests at this point in time. Moreover, the preservation of pension compensation is critically important to the Postal Service if it is to continue to attract and retain qualified and capable managerial personnel.

Thank you, Mr. Chairman, and members of the Committee, for having provided this opportunity to express the views of the National Association of Postmasters of the United States.